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Career Education Q4 2007 Earnings Call Transcript

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Career Education Corporation ([CECO](#))

Q4 2007 Earnings Call

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Executives

Karen King – Vice President of Investor Relations

Gary E. McCullough – President, Chief Financial Officer & Director

Michael J. Graham – Chief Financial Officer, Executive Vice President & Treasurer

Analysts

Cory Greendale – First Analysis Securities, LLC

Jeff Silber – BMO Capital Markets

Robert Craig – Stifel Nicolaus & Company, Inc.

Gordon [Lasik] – Robert W. Baird & Co., Inc.

Brandon Dobell – William Blair & Company

Mark A. Marostica – Piper Jaffray

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Edward J. Yruma – JP Morgan

Analyst for Gary E. Bisbee – Lehman Brothers

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Kevin Doherty – Banc of America

Jennifer Childe – Credit Suisse

Presentation

Operator

Good day ladies and gentlemen and welcome to the fourth quarter 2007 Career Education earnings conference call. My name is Lacy and I'll be your coordinator for today's call. At this time all participants are in a listen only mode. We will be facilitating a question and answer session towards the end of this conference. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to our host for today's call Ms. Karen King, Vice President of Investor Relations. Please proceed.

Karen King

Good morning everyone and thank you for joining us on our fourth quarter 2007 earnings call today. I'm Karen King, Vice President Investor Relations and with me today are Gary McCullough, our president and chief executive officer and Mike Graham, our chief financial officer. Following a brief presentation by management, the call will be opened for analyst and investor questions. This conference call is being webcast live on the investor relations section of our website at www.CareerEd.com. The replay will also be available on our site. If we are unable to answer your questions during the call, please call our investor relations department at 847-585-3899.

Before I turn the call over to Gary, let me remind you that yesterday's press release and the presentations made by our executives may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on information currently available to us and involve risk and uncertainties that could cause our actual results, performance and business prospects and

opportunities to differ materially from those expressed in or implied by these statements. These risks and uncertainties include but are not limited to those factors identified in our fourth quarter earnings release and in our annual report on Form 10K for the year ended December 31, 2006 and from time-to-time in our other filings with the Securities & Exchange Commission. Except as expressly required by law we undertake no obligation to update such forward looking statements or to publically announce the results of any of these statements to reflect future events, development or changed circumstances or for any other reason.

Now, let me turn the call over to Gary McCullough.

Gary E. McCullough

Good morning and thank you for joining us as we review our 2007 fourth quarter and full year results. As Karen indicated, I'm joined on this call by Mike Graham, our executive vice president and chief financial officer. Together, we have a lot to cover this morning.

I'll begin by discussing several things: our fourth quarter operating results and progress we made in key areas in 2007, the disposition of the schools we have held for sale, our general thinking related to the status of the student lending environment in which we're operating and our recently announced restructuring and cost reduction efforts. Mike will follow me with more specific financial results and ramifications. Following our comments we'll open the lines and respond to your questions.

First, the fourth quarter results. We continued to show improvement in key metrics during the fourth quarter. Our student starts and our continuing operations were up 12% year-over-year. Like last quarter, we continued to see growth in new student starts in each segment except colleges. We were able to achieve that 12% start improvement while reducing our cost per start by nearly 17%. This decrease was driven by the elimination of non-productive media, resizing of our admissions staff with 27% fewer admissions representatives than last year and realigning our admissions process with two distinct steps: better qualifying leads and more personalized admissions advising. Population in continuing schools improved through the latter half of 2007 reach mid single digit growth. Our population as of January 31, 2008 was just under 90,000 students, up 6% from January 31, 2007. We remain quite dissatisfied with the 8.8% operating margin we posted in the fourth quarter. If you remove the impact

of [peach house] in both years, operating margin would be 11.2% in 2007 versus 11% the prior year fourth quarter.

2007 was a year of significant change for our company. It marked a period during which we were forced to recognize significant deficiencies in our operations. In the nine months I was on board in 2007, I took steps to address issues on a number of fronts. First, we strengthened our leadership team with experienced professionals who are already making a positive mark on our businesses. Since our last call we announced the addition of Jeffrey Ayers as our new senior vice president and general counsel. Jeff is a seasoned chief legal officer with significant transactional, SEC and compliance experience. He has practiced law for more than 20 years in both law firms and publically traded companies. Prior to Jeff joining the company, I also strengthened our executive leadership team by adding Mike our new CFO, new leadership in marketing and admissions and a new leader for our administrative functions.

In 2007 we also made significant progress in addressing legal, regulatory and accreditation issues. That progress has continued into early 2008. During the year we were able to resolve certain securities and shareholder litigation as well as class action litigation. Justice department inquiries were resolved with no action taken against the company. Then, just recently, we announced that we had been advised of the SEC investigation that was opened early 2004 has been completed again, with no action taken against the company. Perhaps most important, in mid December, we announced that the Commission on Colleges of FACTS had removed American Intercontinental University from probation. This was a significant milestone for the company and we were proud of the staff and faculty of AIU that worked so hard to implement and now sustained the FACTS recommendations. The AIU team has begun the process of renewing the brand, the objectives of their relaunch are to improve AIU's representation to increase AIU's awareness and to increase population. In January, each of AIU's websites was redesigned and advertising was launched across a variety of media with consistent messaging aimed at helping perspective students better understand how AIU can support them in obtaining their desired degree.

Now, let me turn my attention to my comments to discontinued operations. I'd like to take some time to discuss our announcements from last Friday where we announced the decision to teach out =most of the schools held-for-sale since late 2006, the exceptions being two Gibbs campuses for

which we are seeking regulatory approval to convert to Stanford-Brown schools. When I spoke with you last quarter we had broken up negotiations to sell all of these schools to an interested buyer. We made the decision to look at each school individually to determine their future disposition. In considering the alternatives to a sale, we met with the leadership of each school and we viewed a significant amount of data. We considered among other things, each school's current financial performance and forecasts, real estate aspects including capacity utilization and potential sublease alternatives within each school, their location and viability of the current school or conversion to another CEC school in that location and the level of interest and value we have seen from potential buyers for individual schools.

During that period we were approached by another buyer with an interest in purchasing all of the schools. Despite extended negotiations we still could not find a suitable arrangement that would also protect the long and short term interest of our students, faculty and other constituencies. Despite great effort on the part of faculty and staff of these institutions it was clear the schools would not become financially viable within a reasonable period of time. Accordingly, we made the decision to move forward with teach outs. In the fourth quarter we also announced a teach out of IDT Toronto. That campus was only marginally profitable, largely as a result of a suboptimal lease arrangement. In addition, we are unable to offer degree programs and online learning in Canada which is a critical element of the strategy for our academy schools. These factors made us receptive to an offer from a third party to relieve us of a lease obligation of nearly \$30 million that ran through the year 2017 and allowed us to teach out the campus in a responsible manner. Finally, two days ago we announced the teach out of the Las Angeles campus of AIU. The impact of the two year FACTS probation resulted in a significant population decline at that campus. This, combined with the current student market for our programs in Las Angeles made the continued operation of that campus unattainable. Mike will provide more detail on the financial implications of these decisions when he speaks.

While we saw steady progress through the year, the development of our strategic plan and insights from our new leadership team brought progressive thinking about the future direction of our company. The facts are clear, as the company's revenues declined over the past several years, academic, marketing and admissions and other administrative costs

continued to rise. In the fourth quarter we started to address these costs. During our planning last fall we acknowledged that we needed to make significant structural changes to our organization to ensure the best possible student outcomes to continue to grow and to generate acceptable returns. We determined that we need to simplify our structure in order to reduce redundancies, to better utilize our size and scale by using shared resource or service centers and to develop more consistent processes throughout the company. We concluded that we would need to make hard and potentially unpopular decisions to help the long term interest of our employee, students and stakeholders.

As a result, we have embarked on the following initiatives: first, we eliminated the group president layer in order to simplify decision making. I didn't feel there was sufficient incremental value at that level to warrant keeping the positions. We formed strategic business units, or SBUs which better align our key schools consistent with their educational focus areas. We have redefined and clarified the expectations of senior leaders. Our previous managing director roles were narrowly defined and were short term focused primarily on starts and on day-to-day campus management. There was insufficient focus on medium to long term planning and the achievement of quality institutional and student outcomes like retention, graduation and placement. Going forward our SBU heads and their functional direct reports will be expected to take a more balanced business approach. Obviously, we'll continue to drive forth start and population growth. However, the SBU teams will also be expected to develop and own long term action plans. They will also own with the guidance and support from the corporate headquarters brand strategy including where appropriate decisions to rebrand or even eliminate brands. I'll also expect that the SBUs drive more consistency in certain aspects of the business including programmatic consistency within the SBU, the consistent use of corporate functions and campus staffing practices.

We've also committed to improve on our shared services capabilities. We believe we can better align and leverage our efforts in a number of other areas including procurement, certain HR functions, lead generations including media buy and mix management, agency selection and management and alumni relations and certain career services. These are only some of the areas that we've identified. We'll soon complete the integration of student finance and the centralization of all payroll functions. This companywide restructuring has already resulted in the reduction of our

workforce, primarily the corporate headquarters and group level staffs. We have reduced our workforce by approximately 220 positions this year which is anticipated to result in a net savings of approximately \$18 to \$20 million after severance of approximately \$2 million in 2008. We expect that the severance cost will be primarily recognized in the first quarter of 2008 and that the savings will begin to materialize beginning in the second quarter. As the schools align their resources around the new structure we expect that further reductions at the campus or SBU level could occur.

Now, let me discuss another topic that I know is top of mind for all of us. That is the current situation in the lending markets and its impact on our company. I won't sugarcoat it, the situation for us is challenging and Sally Mae's recent decisions will have an impact on our company. But, I believe when we make the necessary changes in our programs and operations we'll look back at this period at a catalyst in making our company stronger.

As part of our strategic business planning process, and in part driven by the change in the lending environment we recognize a large opportunity to reposition our culinary business for better results. To date, the culinary business has experienced good levels of growth and profitability but recently the growth trend has been leveling off. As we examine the program during the fall we focused on a number of areas: the accelerated nature of the curriculum, the utilization of private funding, our marketing approach which should become more national in scope then local and retention, graduation and placement rates. We're pleased with our graduation and placement rates in culinary however, some students fail to graduate on time and the combination of tuition and related school costs, in school loan payments and housing creates an increased level of private funding for some students. Additionally, a larger portion of our culinary students utilize recourse loans and our extended payment plan than in any other of our SBUs. As we increase our focus on students that have both the desire and the financial capability to attend our programs and those who will be successful in their academic pursuits, we expect to significantly alter our approach in our culinary business including resizing the schools and staffing levels.

We have decided to seek state and accredited approval to lengthen certain of our programs. We anticipate that the approval process for this will take approximately six to nine months but, we expect that the benefits from this action will be significant. The Le Cordon Bleu associate degree program will be extended on average from 15 months to 18 or 21 months. This will

allow a student to spend fewer hours in class each week with more opportunity to gain employment while they are in school, more flexibility to maintain the educational pace if a class absence should occur and more time to work with our instructors in the classroom setting over the course of the program. Our students will also be eligible for an additional year of Title IV loans.

Over the years we've increased the population of schools and as we've done that many students relocated and incurred housing expenses. For students without strong financial resources or credit histories, this results in relatively larger out of school payments. We are refocusing our recruiting efforts on local markets to gain more in market students and reduce some of the need for funding of our students. In addition, we'll strengthen our already robust high school program so students and their families can take advantage of federal plus loans. Our new start ups in culinary will be based on an operating footprint of approximately 15,000 to 35,000 square feet versus an average today of 85,000 square feet. We are sizing the real estate to specific market potential rather than to a corporate wide standard. Finally, we are examining our curriculum to add more certificate based programs similar to our kitchen academy programs. We have already had five schools introduce a certificate LCB curriculum and we'll roll out this offering to the rest of the culinary LCB schools throughout the year.

This has been a broad overview of our direction and our thinking. Now, let me turn over to Mike Graham who will provide more details.

Michael J. Graham

Let me spend some additional time on our teach out and student lending details before I end with the fourth quarter results. In the past 60 days we've announced a teach out of 11 schools including nine of which that were previously held-for-sale. The 11 schools are comprised of seven from the Gibbs division, two from the college division, one from the academy division and one from the university division. We're seeking approval to convert the two remaining schools held-for-sale, Gibbs College in Vienna, Virginia and Katherine Gibbs School in Melville, New York to Stanford-Brown campuses focusing on allied health programs.

As part of our reorganization we have named an experienced leader who will run our transitional schools segments. We believe this focus will allow us to wind down the operations of these campuses in the most cost efficient

manner while making sure every student is served until the end of the program. In 2008, our GAAP reporting structure will include a transitional school segments. Beginning in the first quarter 2008, the results for the nine schools originally held-for-sale that are now being taught out will be part of continuing operations within this segment. For the full year 2007 the revenue and net loss, net of tax for the nine schools was approximately \$103 million and \$36 million respectively. Included in this net loss was a pre-tax charge for approximately \$29 million to recognize the impairment and write down of the schools to their fair value. We estimate that these nine schools will incur a 2008 operating loss of approximately \$25 to \$35 million.

The existing teach outs of the two Brooks College campuses and IAD Pittsburgh and the 11 teach outs announced in the past 60 days, our estimated incurred and annual operating loss of \$50 to \$65 million for 2008. The losses in 2007 from operating the Brooks Colleges, IADT Pittsburg and Toronto as well as the IAU Los Angeles campus were reflected in the previous operating segments. The estimated 2008 loss for these schools is not materially different from the losses those schools experienced in 2007. This loss is comprised of the net operating loss of running the schools, onetime cost for severance, the cost of existing real estate obligations when the teach out is complete. We do not anticipate existing any of the real estate of the former schools held for sale during 2008. Most real estate exist activity for these schools will occur in 2009 and we estimate a pre-tax charge in 2009 of between \$55 and \$75 million upon exiting the nine schools. This estimate is a combination of the present value of the then remaining real estate obligations less our estimate of sublet income. This estimate is subject to significant change to the nature and timing of the teach outs and also the condition of the local real estate markets.

Let me turn to lending. Career Education Corp. and Sally Mae have enjoyed a very positive and productive relationship since 2002 with Sally Mae providing important financial resources for our students allowing them to pursue their education. Approximately \$2.7 million of the company's 2007 domestic cash receipts including those from the discontinued operations was related to Sally Mae recourse loan programs. This amount of which excludes the related Title IV loan programs and program funding received for these students. Since March 2007 we have been in a risk sharing agreement with Sally Mae to provide recourse loans to our students at a 25% discount fee to the company. On January 18, 2008 we received

notification from Sally Mae that Sally Mae was terminating the discount loan program effective February 18, 2008. Subsequent discussions with Sally Mae resulted in an extension of that termination dated agreement to March 31, 2008 with an increase in the discount rate for that interim period to 44%. This higher discount rate will result in an additional expense in the first quarter of approximately \$1 million. The extension was granted by Sally Mae to help facilitate our ability to replace Sally Mae as a lender to these students.

As we disclosed in our form 8K filed with the SEC we were working with Sally Mae to arrange continued funding for active students that currently utilize Sally Mae recourse loans. Although all conversations with senior level representatives of Sally Mae were positive and indicated they would continue to lend to these students when entering their second or subsequent academic years known as serial volume and this would be at an increased discount fee to the company we were notified on February 14, 2008 that Sally Mae would no longer continue to offer recourse loans to these students and removed certain FICO bands above the recourse level from their non-recourse programs. We do not view ourselves as a lender nor do we see this as a potential core competency. We have traditionally provided limited financial assistance to students through our extended payments program. This program identifies students that have special needs who did not qualify for private lenders programs and to date we have only approximately \$12 million of outstanding balances under payment plans to students. However the current credit environment and the termination by Sally Mae has created very difficult conditions for our students and we believe that it is in the long term interest in the company and the students to provide some transitional financial assistance to these students so they can continue their program to graduation and better enable them to repay their financial commitments. We estimate that in 2008 we will need to provide approximately \$15 to \$20 million of financing for this serial volume under programs beginning April 1, 2008. The amount of new financings in 2009 is also estimated to be incremental \$15 to \$20 million. For these financings we will need to establish the appropriate bad debt allowance required for anticipated charge offs. We do not have collections history with this student base as they were funded by Sally Mae and we will initially assume a 44% allowance rate consistent with the rate offered to us in the recourse program by Sally Mae. This rate will change over time and will be subject to a large degree of estimation. We are finalizing the details of this program over the next several weeks.

We will also need to replace the loan capacity no longer provided by Sally Mae for new starts. We've taken the following steps that we expect to have in place by April 1st. First we've been in discussion with a number of lenders whom we expect will step in to fund a portion of potential students with better credit histories or students who have not yet established a credit history. Second we will use our balance sheet to provide payment plans to the most credit worthy and the lowest potential default risk candidates to whom our private loan providers have denied credit. We believe this is a sound decision as these students deserve the opportunity to gain an education and we can help them without experiencing a material financial loss. We recognize that these students have higher default rates and expect to design our programs to provide the lowest possible out of school payments for the student. While we have provided these payment plans in the past as I spoke of earlier, we will now require students to have higher FICO ratings in the sub-prime category than to those to whom we have historically provided our funding. Third we are examining grant programs and scholarship opportunities to help students. We are in the early stages of this work which may be subject to institutional and regulatory guidelines. We are also requiring that our financial aid advisors more consistently work to help candidates identify co-borrowers that allow them to qualify for traditional private loans.

We've closely examined each of our SBU's to determine the extent of reliance on the recourse loan programs. The culinary SBU had the highest historical use of this product and Gary spoke earlier regarding the steps we've taken to insure the long term success of the program. The remainder of the SBUs utilize a more limited amount of the recourse loan products and of our extended payment plan. Our new payment plans are being finalized. We're designing the program to carry an interest rate below the current recourse products offer by Sally Mae which we expect will result in total out of school payments including Title IV of no more than \$450 to \$500 for an associate degree candidate or graduate and \$700 to \$800 for Bachelor degree graduate and the loans will generally be capped at a \$9,000 level per academic year. We believe this plan will provide an estimated \$10 to \$15 million of financing in 2008 and an additional \$10 to \$15 million of financing in 2009 in addition to the serial volume I spoke of earlier. We will suspend the use of our extended payment plan for new starts as we've done in the past with a lower FICO score level which is expected to reduce revenue by approximately \$20 to \$25 million in 2008. We will continue in discussions with our lending partners as the credit

markets recover to develop products for students in the form of recourse level.

Additionally, we are continuing discussions with various third parties venture into a purchase agreement with recourse to the company. In summary we estimate the loss of the Sally Mae recourse program and the lengthening of the culinary program will reduce the company's 2008 culinary arts segment revenue between \$50 to \$65 million and will reduce all other segments in the aggregate by approximately \$25 to \$35 million. Our new payment plan will add back revenues of approximately \$20 to \$25 million and new lenders are estimated to add back up to \$10 million of revenues. So including discontinuing the extended payment plan as exists now and its related revenue we estimate the total net loss of revenue in 2008 to be between \$75 and \$100 million which we expect to result in a potential operating income reduction of \$40 to \$60 million in 2008 subject to further cost reductions, additional marketing efficiencies and alternative lender opportunities.

Now let me give you some financial details on the fourth quarter. As Gary indicated we we're pleased with our fourth quarter results. The results reflect progress we've made in many of the near term initiatives that we've put in place. The fourth quarter revenue for 2007 was \$437.2 million up six tenths of a percent from the fourth quarter of 2006 which is the result of several quarters of improving starts and population. The increase was aided by an additional \$8.7 million in international revenue from Istituto Marangoni which was purchased early in 2007. For our university online schools, student revenue for the fourth quarter decreased 4% from the prior year, which is improving from the decline of 16.7% in the third quarter of 2007. While AIU online and ground continued to have significant negative impact on year-over-year comparisons, the relative overall decline is diminishing each quarter as a result of the significant growth at CTU. CTU online currently accounts for close to 50% of the revenue and 60% of the operating profit of our online schools in the university segment. AIU online population decreased 4% this quarter, while CTU online population increased nearly 30%. AIU online revenue was down 18%, while CTU online revenue was up 17%.

Consolidated operating income was \$38.4 million during the fourth quarter of 2007 down from \$42.5 million during the fourth quarter of 2006. Operating profit and margin percentage for the fourth quarter was 8.8% versus 9.8% for the fourth quarter of 2006. There were several unusual

items included in the fourth quarter of 2007 as well as the fourth quarter of 2006 which had a significant impact on margins. In the fourth quarter of 2007 the academy segments included \$2.1 million for the rated cost of severance in teach outs of Toronto. The academy and colleges segments included a \$5.8 million asset impairment charge, related to the teach outs of the schools, and our health education segment included a \$6.5 million increase to legal reserves for anticipated legal settlements. In the fourth quarter of 2006 there was a \$4.4 million impairment related to several schools in the colleges segments and a \$4.1 million severance expense representing payments payable to the company's former chairman. The decrease in operating profit margins of the factors I just discussed was offset in part by a reduction in the admission representative headcount and improved rep productivity, a decline in our administration expenses due to a reduction in corporate spending and overall improved efficiencies in our advertising.

The university segments fully online platforms operating profit margin declined to 21.6% during the fourth quarter of 2007 down from 22.1% in the fourth quarter of 2006. AIU operating profit margin was 14.9% down from 25.6% in the fourth quarter of 2006. CTU online was 29% up from 16.5% in the fourth quarter of 2006. AIU has many initiatives under way to improve its profitability. AIU is preparing to launch new programs and concentrations throughout 2008, the majority of which are bachelors and master level programs. In addition, programs that are no longer viable will be phased out over time. Both of these initiatives were prohibited over the past two years while AIU was on probation. AIU has launched a \$12 million new media campaign utilizing multiple outlets including Internet, print, and TV. The majority of the expense for this campaign will be incurred in the first quarter, however, we anticipate savings in the second half of 2008 versus the prior year, in advertising cost it will offset about half of this investment. AIU is also teaching out the Los Angeles ground campus, which accounts for approximately 50% of the loss of all AIU ground campuses in 2007. We've also determined that our agreement with AU Dubai, was no longer of strategic importance and we mutually agreed with the school to end our agreement effective January 1, 2008. The termination provided us with a payment in 2008 of the equivalent of two years annualized revenue. AIU is also initiating a series of changes that will better leverage the power of the entire university. AIU is realigning the university's central administration and staffing at each campus, consistent with current population and promoting the use of online classes at all ground campuses to achieve scheduling

efficiencies and better address student's needs. Last, AIU has aligned the ground and online educational calendars beginning January 1, 2008, to better enable ground students and online students to use each other's programs, this will result in a shift of earnings days from Q1 to Q3 for AIU online, moving approximately \$6 million of operating income from the first quarter to the third quarter of 2008.

Let me wrap up with a discussion of investments, repurchase program, highlights from our balance sheet, and some perspectives on 2008. As of December 31, 2007 we had approximately \$154 million of municipal bond auction rate securities that are rated AAA, and as of February 20, we only held \$46 million of such securities. We've carefully monitored the auction rate markets and have actively reduced our position over the last several months. All holdings have an underlying credit rating of A or better exclusive of the monocline credit enhancements and we feel comfortable we can hold the securities through market obstructions without risk to principal.

Turning our repurchase program during the fourth quarter of 2007, we repurchased 2.5 million shares at approximately \$75 million or an average price of \$29.47 per share. From the inception of the buyback program in July of 2006 through the end of 2007, the company has repurchased 18.2 million shares for approximately \$591 million and we have remaining authorization as of December 31, 2007 of approximately \$210 million. As of December 31, 2007 we had \$382 million in cash and investments. Our first priority is to maintain adequate liquidity to meet financial responsibility requirements of the DOE and to finance the limited amount of student receivables I discussed earlier. Our second priority continues to be to reinvest into high growth opportunities, such as selective start ups, technology, and new programs. From there we look to return cash to shareholders. In 2007, we purchased an unusually high volume of shares at a total value of \$224.3 million, as we enter 2008 we will continue to deploy our cash to the highest return.

Our annual DSO's, days sales outstanding, were 14 days at the end of December, an increase of three days from December 31, 2006. This increase is primarily due to increased centralization of processing of student loans and also the timing of the release of Title IV money near the end of the year. For the year, capital expenditures decreased to \$57.6 million or 3.2% of revenue, including discontinued operations revenue during 2007 down from \$69.5 million in 2006.

Needless to say we enter 2008 with many challenges and many opportunities, we've highlighted this morning the impact in 2008 of the changes we are making in the business. We will have a significant amount of change in our quarterly earnings pattern, especially in the first quarter, with the investment in AIU marketing, the change in earnings days, and the severance costs. Additionally, in the first quarter of 2008, our schools will be reported in the new SBU segment structure. Our start and population figures for the fourth quarter in our press release have been adjusted for certain non comparable items, including the removal of AU Dubai, which was previously in the university segment and the teach out of Toronto which was previously included in the academy segment. With that let me turn it back to Gary.

Gary E. McCullough

We'll open the lines to your questions.

Question-and-Answer Session

Operator

(Operator Instructions) Our first question will come to us from the line of Cory Greendale with First Analysis. Please proceed.

Cory Greendale – First Analysis Securities, LLC

A couple of questions, Mike, I know you took a kind of a topped out approach with what the impact will be, but can you talk a little bit about the FICO score narrowing that you discussed, how much narrower it is, what percent of your population would be in the band that is no longer going to be able to access those loans from Sally Mae that would have otherwise.

Michael J. Graham

Again, we typically don't discuss the population, you can see from the funding tables and the use of the recourse loans in our footnote how much of the population was under recourse loans of 2.7% of our revenues. Needless to say we are walking away from the FICO bands below the recourse level, which are the lowest part of sub-prime, FICO bands, we are having our lenders step into the higher end band of Sally Mae's FICO scores and then we will take a higher level of the recourse band left behind by Sally Mae but we're not going to discuss the individual FICO cut offs at

this time.

Cory Greendale – First Analysis Securities, LLC

It's really the in between part, I think you mentioned that there was a portion of the non-recourse program where there raising the level can you just give any sense of the magnitude of what portion of the population that part of it impacts?

Michael J. Graham

I can't give specifics on that number. Let me think about a disclosure for that and if we're willing to disclose that. At the current time we don't have that number and I'm not sure we're ready to disclose that.

Cory Greendale – First Analysis Securities, LLC

Okay and on the culinary segment can you just give a sense as to is the change in the square footage a reasonable sense of what will happen to the population there as well?

Michael J. Graham

I don't think so. I think what we're saying is that we built our facility have been built to a large size that accommodate both a local market and a national market. As we have now looked at the efficiency of those spaces the current space of 80,000 plus square feet is not the most efficient use of space and as we have designed new boxes we have taken down that square footage on our most recent designs. We are also saying now that we'll continue that and we'll probably also limit that as we get more local in the nature of the programs than we would in the national program. Additionally, as we look at culinary we expect that over time as we get more local and the initiatives improve our population will rise again. We'll have a dip in our population from Sally Mae and we will extend out the program but as we get to a more normalized state in 2009 we'll keep the real estate we have but we'll go back into some of the real estate as the population comes back.

Gary E. McCullough

It's important to note that we don't, we're not saying that at 80,000 or 85,000 square feet by going to you know 15 to 35 that the population is

going to be reduced in accordance with that. That's not what we're saying at all. We're just saying that as we go forward and we plan to go forward and continue investing in our culinary business we expect we'll be more efficient by redesigning the new boxes that we build out.

Cory Greendale – First Analysis Securities, LLC

Okay. There may be a better way to ask, do you know what the percent capacity utilization is in the culinary program right now?

Michael J. Graham

It's again we don't use percent capacity utilization, we understand our square foot per student it's in excess - there's also as we designed the schools in terms of excess space and in terms of the flow of the school and the teacher ratios and the size of the classrooms we've got a much better model that we've done over time between learning from Kitchen Academy and learning from the LCB, the new start ups including the one we built in Dallas this year and the next start up that we plan for 09.

Operator

And our next question will come from the line of Jeff Silber with BMO Capital Market. Please proceed.

Jeff Silber – BMO Capital Markets

I'm a little bit confused on the numbers and if you could just help me walk through it I would appreciate it. You keep on referring to this 2.7% of I believe cash receipts for Sally Mae recourse yet in looking at the impact on revenues in 2008 we're talking about \$75 to \$100 million which is larger than that, so do I assume that that 2.7% is impacted as well as certain component of the non-recourse loans? If you could kind of walk me through it I would appreciate it.

Michael J. Graham

There's a couple of pieces of it. First, remember the 2.7 is the portion of the Sally Mae cash receipts so for all of those students they also received Title IV money which is shown above. So the loss of the revenue from Sally Mae is not only the 2.7 that Sally Mae is no longer funding but also the revenue that comes with the Title IV funding. Additional, we have walked away from

some of our extended payment programs below those FICO scores which are not in the private loan category and additional we will lose some revenues in the above FICO bands where Sally Mae is not going to finance those. So that the combination of those plus the addition to tuition revenue and cash receipts there's other revenue such as housing revenue, books revenue, supplies revenue, things like that that get us to our estimate of \$75 to \$100 million based on the details of the programs we've worked through.

Jeff Silber – BMO Capital Markets

Okay and just going back to the culinary program you said that these students had to take, a larger percentage of these students relative to your other SBUs that take out these recourse loans. Can you give us some sort of quantification on how that compares to the rest of the business?

Michael J. Graham

I would say that the two highest users of the recourse loan programs have historically been the culinary group and the Gibbs group. The lowest users of our recourse programs have been our online groups. If you look at the use of culinary and Gibbs, on average it's probably 50% higher than some of the other SBUs in terms of their uses of program. That said our cohort default rates our culinary business has the best cohort default rate of any of our businesses at just below 7% so it's a mix that we have our population we have high repayments from our students with a recourse element in there so our default rates are better on the cohort default rate than the remainder of our programs.

Jeff Silber – BMO Capital Markets

Okay and then shifting gears over the to the transitional school segments, going forward just so I understand this transitional school segment, it only includes the nine school that you're now bringing back into continued operation but in terms of the other teach outs Brooks, IADT, IAU. Those are not going to be in there their going to be in their respected SBUs?

Gary E. McCullough

No that's not correct Jeff. What we're saying is that all of the schools that we've chosen to teach out including Brooks and the AIU schools will go into

that transition group so we can accomplish with them and teach them out both effectively and expeditiously.

Michael J. Graham

I think it's meaningful we've put a leader in place in the teach outs to make sure that the students are served well and also we minimized the cost obstruction and we do it in the most efficient way possible. For accounting reasons as we have a senior leader reporting to Gary doing that, this will provide you going forward transparency on all the teach outs on a comparable basis so all the teach outs in the past and going forward will be in this transitional segment and separate from the ordinary SBUs and the SBU leaders no longer are focusing on the teach out their focusing on start ups in their regular business.

Gary E. McCullough

Jeff what we have found is that the skill sets and the requirements of doing one or the other are different and so we want to folks who are running our continuing operations to focus on those things that are necessary to continue to grow the population and serve the students well. The folks who are dealing with the teach outs again, it's a different task at hand and we want them to be able to focus on that one and do that well. So we separated them out to insure the appropriate focus on the task at hand.

Jeff Silber – BMO Capital Markets

Okay and that makes a lot of sense and in terms of getting us the historical transitional school data is that something you're going to be disclosing separately in 2007 in terms of on a quarterly basis how that specific SBU did?

Michael J. Graham

I think first in the first quarter we'll have the restatements and they'll be restated back appropriately. Second, is we have given some guidance in the script of the number that the schools have done in the past and are doing in 08 so we gave a number of \$50 to \$65 million for this unit next year which we said is not materially different then what they experienced in 07 so that will give you a basis of the carve outs.

Jeff Silber – BMO Capital Markets

But we won't get the quarterly data until the first quarter?

Michael J. Graham

Correct.

Operator

And our next question will come from the line of Bob Craig with Stifel Nicolaus. Please proceed.

Robert Craig – Stifel Nicolaus & Company, Inc.

Mike, you threw out a lot of numbers I just wanted to make sure I had the net effect on operating profit in 2008 excluding the teach outs from the lending issues, other moves and the cost cutting initiatives?

Michael J. Graham

Okay I think what we - let me just go out to my notes.

Robert Craig – Stifel Nicolaus & Company, Inc.

Basically \$40 to \$60 million less 18 to 20?

Michael J. Graham

Right we had spoke to - the lending impact would be \$40 to \$60 million and then we believe that the savings and severance on the restructure would be \$18 to \$20 million. And if you look at the teach outs from what we experienced in 07 and will experience in 08 they won't be materially different you have the discontinued versus continuing operation that we would move around.

Robert Craig – Stifel Nicolaus & Company, Inc.

Okay.

Michael J. Graham

We also spoke to an incremental investment of \$12 million in AIU offset by \$6 million in savings later in the year that we spoke to potentially you know the \$1 million of recourse increase in the first quarter on Sally Mae from the

25% to the 44%. Does that help?

Robert Craig – Stifel Nicolaus & Company, Inc.

Okay that does help. Thank you. Could you also describe overall efforts to increase your percentage of Title IV, I think you alluded to additional cosigners and so on but I've heard others talk about the opportunities in the plus loan area, maybe the direct program, etcetera.

Gary E. McCullough

I spoke about the efforts that we're making in the culinary program to extend the program because what we have found as we looked at our programs and we looked competitively, our programs tend to be shorter, our programs because they are so concentrated we end up having people who might be ill and miss a class or two left to extend and they find themselves in a situation the program costs while competitive they are concentrated. So by extended the programs out to 18 to 21 months it enables them to access an additional year of Title IV funding and we think that will be helpful to those students overall. That's probably the biggest significant shift that we're making programmatically in our business.

Michael J. Graham

The other things to think about are co-borrowers are very important and we are educating our admission staff better on use of co-borrowers and working closer with the students on co-borrowers versus the recourse program or other programs. We believe that will help we've looked at some of the opportunities. To date our lending partners are there as the conduit versus going directly for the [inaudible] volume and things like that. So we've explored the steps necessary, we haven't necessarily taken all the steps to register and to get that moving forward. So I think a lot of its' education to the admissions team, its use of the co-borrowers, maximize the federal funds that are available and also the mix of business will change a little bit here as we continue to grow the online business and the culinary business ramps down a bit. Does that help?

Robert Craig – Stifel Nicolaus & Company, Inc.

That does help. A couple operational questions, the current admissions rep headcount and staffing plans there going forward I think the last number

you threw out was around 2400.

Gary E. McCullough

That's correct. We are looking at our current admission processes and organization and we think there are other opportunities to reduce headcount going forward. It's not something we've finalized a plan on at this point in time and as we continue to make these changes I expect that the population will decline there as well. But that's again coupled with us making process changes that make the jobs more robust and make the outcomes and how they deal with students more effective and more efficient. So we've made those reductions but we don't believe operationally we're giving up the outcome at the other end in terms of our ability to increase population starts over time.

Michael J. Graham

Bob we've got about 2,300 reps at the end of the fourth quarter down about 27% from last year.

Robert Craig – Stifel Nicolaus & Company, Inc.

Okay and if you gave AIU versus CTU starts I missed that number, did you throw it out?

Michael J. Graham

In the fourth quarter total AIU starts were flat. Total CTU starts were up about 17%, total ground and online.

Operator

And our next question will come from the line of Gordon [Lasik] with Robert W. Baird. Please proceed.

Gordon [Lasik] – Robert W. Baird & Co., Inc.

I just had another follow-up on your Title IV situation, have you seen any indication of Title IV loans are risk or that some of your students are having trouble getting access to that funding?

Gary E. McCullough

We have not.

Gordon [Lasik] – Robert W. Baird & Co., Inc.

Okay and just to clarify you previously talked about, just a follow-up, 2.7% of cash receipts wasn't adding up to the \$75 to \$100 million the difference for that was, can you just?

Michael J. Graham

Again, the comment we gave to Jeff 2.7 was just the recourse portion of the students loan so in addition to that they'll have their Title IV loans, they would have additional revenue related to books, related to housing, other elements there and also we have lost some of the non-recourse loan activity, we've dropped some of our extended payment term activity and we've supplements back with the steps we've laid out and that's how you reconcile back to the 2.7 to our numbers.

Operator

And our next question will come from the line of Brandon Dobell with William Blair. Please proceed.

Brandon Dobell – William Blair & Company

I wonder if I could shift gears a little bit over to AIU and CTU and [inaudible] you talked about extending the program lengths in culinary given the market dynamics, any thoughts to the branding and/or kind of program strategy within those three different opportunities? Do you think you have the right programs in place, the right program lengths, or what the funding programs look like or what the students are telling you?

Gary E. McCullough

One of the things that Mike covered in the script is that AIU we were prohibited for the period of the probation from changing programs and so we had quite a number of programs particularly Bachelor and Master degree programs that we have applied for new programmatic status on those with FACTS and those are in process. We expect those to come on-line soon. So the inability to change programs during that period of time certainly hindered AIU. We also have programs under development and under way at CTU as a normal portion or a normal part of making sure that

the programs are robust. I've been asked a lot of questions with regard to doing we want to keep both the brands and the answer is yes, we think both have a place in our portfolio. I think we do have to look at Stone Cliff and understand its long term viability as a separate free standing brand. Does that help?

Brandon Dobell – William Blair & Company

Yes that does. I guess finally want to make sure that I understand the if we look at the relative exposure of what you guys are talking about with the recourse loan and the payment term change and all that kind of stuff. It sounds like the huge majority of that is going to be in culinary. Any sense that you've really got your arms around the potential issues and different parts besides culinary in terms of funding. I'm just trying to make sure that when we're down in Atlanta in a month or so that or back on the next call that we don't get a little more information about, now we find a different pocket of students, a different program that we think have the same kind of issues as culinary students find.

Gary E. McCullough

We've spent obviously a great deal of time in each of our programs looking at where the issues are and as Mike indicated the significant issues that we face are in our culinary programs and we're making both a programmatic adjustment and as necessary the financial adjustments we'll have to make to do what's right by those students. We do have exposure in each of the other business to a far less extent and we believe that we'll be able to manage those with the programs we're talking about. So you won't you know, we don't believe you'll be seeing incremental surprises, the significant issues we face are in the culinary business.

Michael J. Graham

You know we have spent a lot of time on the issue. We've done a lot of analysis of data that we have from our own payment plans from the different loan sources of our students. We did a business by business by business SBU driven analysis of what additional costs to take out of the business, variable costs versus fixed costs, grant program, funding gaps, everything else to come down to these numbers and the business had been working hard and we feel good given the sea of changes happened that we responded well. Obviously, finding out from Sally Mae a different

change on the 14th of February with our call today, we've done a lot of work in the last week, which is still a work in process, in week to replace the serial volume. We're reluctant to share a lot of the details behind our model for competitive reasons and other reasons, but rest assured we have done this at a very detailed level.

Brandon Dobell – William Blair & Company

Then a final question for you Gary, early on in the call you talked about realigning the business units and trying to drive different focus in your senior leaders, have you changed the compensation schemes to get in accordance with that to try to drive behavior or do you think your compensation schemes are pretty much where they should be?

Michael J. Graham

We have in fact changed our compensation programs, and it's something we've talked board at this point in time, were rolling out, we're actually having a senior leader leading, were bringing people in including campus presidents next week. But as we look back, our bonus programs in particular, we had in excess 10 different programs in the company. We're looking to streamline that and make sure that were all in this together and that we've placed the appropriate focus both at the corporate level, at the SBU level, and reward campus presidents for the right behaviors and the right outcomes as well. So we'll be going through that on in great detail next week with the leaders that were bringing in. It's something that Tom Budlong, who joined us in late August early September, that he is spearheaded along with our HR organization, our compensation committee and the senior leaders in the organization so were in line on how we want to go forward

Operator

Our next question will come from the line of Mark Marostica with Piper Jaffray. Please proceed.

Mark A. Marostica – Piper Jaffray

I wanted to follow up on a couple of questions on AIU, you mentioned your new media campaign, I'm not sure if it's in progress yet, and that's my first question, has it begun? And if so any early returns or comments on the

impact of it?

Gary E. McCullough

We don't have early returns as it's still relatively young at this point, but as Mike mentioned were spending an incremental of \$12 million, actually \$6 million incrementally for the year on the programs. We have addressed the consistency and the look and feel of each of the websites, if you look back, they were significantly different in some cases and so we've aligned them, we've aligned the messaging around again AIU's ability to support students in their quest for the degree that they are seeking. But we have also have done significant radio, outdoor in places where we have ground campuses, and so, ultimately it's a pretty comprehensive program. We have benchmarked where we stood prior to the program launching, but we don't have post data at this point in time, as it's relatively new.

Mark A. Marostica – Piper Jaffray

Regarding the new programs that your seeking approval for at AIU, can you give us a sense for the number of new programs that your seeking approval for and when do you expect to get that approval, and ultimately when do expect to start to see the roll out of those new programs?

Gary E. McCullough

We have seven new programs that have gone in for approval. The approval process is hard to predict but we think it will be several months and ideally we begin to teach those programs at the beginning of the next academic year.

Mark A. Marostica – Piper Jaffray

I don't know if you disclosed this earlier but in January, can you give us a sense of what your start growth looked like for the month of January?

Gary E. McCullough

Actually, I made a decision not to talk about January for a variety of reasons. First of all, Mike talked about the significant number of calendar shifts that we have, the significant changes we've had in startups and teach outs. We've got changes that are going on in the culinary programs and we've got AIU calendar shifts as we start to align the online programs with

the on ground programs. Based upon that I didn't believe a one month start number was as meaningful as it could be with all the noise that was in there. I will tell you this, that our starts were in line with our expectations going forward.

Mark A. Marostica – Piper Jaffray

Then the last question and I'll turn it over, just taking a big step back here on the tuition pricing theme, as you look across the business how should we think about tuition pricing in 08 relative to 07?

Gary E. McCullough

We've assumed tuition pricing will remain as it is. As we've looked across our programs and their relative competitors we believe we are in line. I think the issue we had and I'll go back to what we had in culinary, our overall program costs is in line from a tuition point of view, the short duration of our programs make it more challenging to pay and some of the national marketing that we've done to bring people in have made the program costs above and beyond tuition price less competitive. So, that's what we're seeking to address but, we think across our business our tuition is consistent with the competitors that we're operating against.

Michael J. Graham

Just to be clear, we do not give out and we don't take across the board tuition increases across the entire CEC portfolio. What we do is any tuition increases that are put in are school-by-school and are paced based on historical trends. We can't give you a tonal price mix analyst yet because we do our decisions on pricing and annual increases on a campus-by-campus basis at different times during the year.

Operator

Your next question comes from the line of Sara Gubins with Merrill Lynch. Please proceed.

Sara Gubins – Merrill Lynch

I'm sorry to go back to this but I just want to make sure that I understand the \$75 million in loss revenue related to lending and the \$40 to \$60 million in operating income. The \$75 to \$100 million does that include both the loss

of the recourse program and effectively the loss of some students because of higher underwriting criteria?

Michael J. Graham

Yes.

Sara Gubins – Merrill Lynch

Okay. Then the \$40 to \$60 million, that includes both the fewer students that you'll have plus the incremental bad debt associated with you doing some of this funding on your own?

Michael J. Graham

Yes. But, also at the 44% rate of bad debt that we talked about also still subject to additional cost cuts that we may do with marketing efficiencies or additional sizing that may be appropriate campus-by-campus as we go forward based on the impacts of this.

Sara Gubins – Merrill Lynch

Okay. In terms of the restructuring can you talk about where the headcount reductions were?

Gary E. McCullough

In this initial round we took about 100 positions more or less out of our corporate headquarters. Again, some of those were positions that we had chosen not to fill towards the end of the year. I think about 60 of those were actually individuals who were in roles. We also had as a result of the changes we are making at AIU some downsize that we did at AIU that we were not able to do during the course of the probation that was going on there and of course, the downsize associated with teaching out AIU Los Angeles.

Michael J. Graham

Just to be clear, in terms of headcount number gave the 220 positions that were eliminated that does not include positions related to any of the teach outs because obviously our headcount as the teach outs progress will change. But, these are structural savings from the continuing operations

that we're gaining going forward.

Sara Gubins – Merrill Lynch

In terms of the review of the business, I know it's still ongoing, do you feel like the campuses that you currently have are the right set of campuses? Or, do you expect more significant changes?

Gary E. McCullough

Would you say that again please?

Sara Gubins – Merrill Lynch

I'm just wondering, you've gone through a round of decisions to do teach outs and I'm just wondering if you now feel like you've gone through the campuses that you have and kind of the decisions that have been made are the ones that you'll execute but that you're in good shape with the rest of them?

Gary E. McCullough

The answer is yes, we think this is the right thing to do at this point in time. As we've discussed previously we did the strategic planning process and as we came through that process we identified that there were a number of schools that were not operating efficiently as we would like them to operate. We'll continue to monitor those, we're redoubling our efforts to make sure those schools improve their performance over time. One of the things that we still need to do as we continue our restructuring is look at each of the campuses. There are significant variations in campuses in terms of the number of staff and faculty and in some cases for operations that are similar in size in terms of serving students. So, we think we can be more efficient on the campuses but at this point our focus is on driving the effectiveness of the campuses we have and we think we've dealt with the most significant issues at this point of time.

Michael J. Graham

Specifically in the near term as we get the new alignment of SBU leaders in place and let their activity take hold. It will give us a chance here to see the results of the campuses under the leadership.

Sara Gubins – Merrill Lynch

Okay. Last, unrelated question, can you talk about whether or not you're looking at international expansion at this point? And, if you are, if it's something that you view as imminent?

Gary E. McCullough

The answer is that we have some people in our organization, in our mergers and acquisition group who are appropriately I think, understanding the market places outside of the United States. But, I will say once again, our focus at the moment is on fixing our current and continuing business here domestically. We have an international operation that is performing quite nicely in Europe but, at the moment, our focus is on driving better performance at our schools here domestically.

Operator

Your next question will come from the line of Edward Yruma with JP Morgan. Please proceed.

Edward J. Yruma – JP Morgan

Just one housekeeping item, how much of the charge is actually cash?

Michael J. Graham

How much of which charge?

Edward J. Yruma – JP Morgan

The onetime charges that you've announced.

Michael J. Graham

Well, you've got the \$2 million of severance to look at that we've disclosed which is all cash. As you look at the teach outs we haven't given details but the majority of the teach out costs will be cash. You will have the combination of the severance that will be cash. You do accelerate the recognition of the leasehold over a shorter period of time, that is just acceleration, that is non-cash. You saw the \$5.8 million impairment that we took there in that teach out. At the end, the 2009 charge which is a real

estate charge, that is theoretically a non-cash charge because you're bringing it on the balance sheet, a future obligation but, that is cash over the period that you pay out those leases.

Edward J. Yruma – JP Morgan

But you say you've accelerated that, correct?

Michael J. Graham

No, we accelerate that when the facilities go dark and most of that charge on that real estate, the closure charge, the asset retirement obligation would be in 09. The acceleration over the teach out period is for those leasehold improvements related to a lease that get accelerated from a lease term now over the shorter period of the remaining teach out.

Edward J. Yruma – JP Morgan

One follow up if I may, is there a specific cash balance you must maintain for the FFR ratio?

Michael J. Graham

There is a DEO requirement in terms of the financial responsibility that doesn't necessarily have a certain cash ratio, there are three different ratios with different weightings that you have to comply with. We last year, in 2006 we disclosed that we were at a 3.0. We are not finished with our calculation right now for 2007 but we are well north of 2.5 and as we look forward on our DOE ration under this financing and the changes that we're making we do not feel that we'll have a new risk of being at a 1.5 or anything else that would cause a problem with the DOE ratio.

Operator

Our next question will come from the line of Gary Bisbee of Lehman Brothers. Please proceed.

Analyst for Gary E. Bisbee – Lehman Brothers

Just a question back on the AIU program changes, you talked a little about the tightening credit markets and the impact they're having on culinary and accelerated programs there. If I remember right, AIU part of the value

proposition there is that it's an accelerated format which results in a little bit of a higher tuition revenue per year. Is there any thought as far as those programmatic changes into lengthening the program there and maybe spreading it out over more academic years to get more Title IV financing?

Gary E. McCullough

At this point it's not something that we turn our attention to. As Mike said, we've been working hard to react to some of the news we've gotten lately. It will be something that we'll be asking each of our SBU heads to address as they look at their programs and the effectiveness of the programs and whether we're taking maximum advantage of the various funding sources that are available but it's nothing to be contemplated at this point in time.

Analyst for Gary E. Bisbee – Lehman Brothers

Then maybe you could help us understand some of the things that the lenders you are talking to are thinking about as you talk to a couple of them about replacing the Sally Mae recourse arrangement? Have they given – where are they giving you the push back, is it more on what the actual discount rate should be? Or, is it just that they're not in this environment willing to make loans at any discount rate?

Michael J. Graham

I don't think we're going to get a lot of clarity on negotiations which are still going forward. Needless to say, the lenders are all being cautious in the environment, they are looking at their balance sheet and their capacity. We're talking about a variety of different programs where people can come in and help us with no credit score students that have a good default profile, they just haven't established credit yet. Different lenders are looking at different parts of Sally Mae that are left behind and trying to find where they can benefit as a partner to be into the program.

Analyst for Gary E. Bisbee – Lehman Brothers

Then just my last question, I'm wondering if you can provide some insight about how you were thinking about the tradeoff between the tightening of your own credit standards on who you are admitting versus potentially using more of your balance sheet to admit students and capture some of the Title IV revenue from them and potentially offsetting the negative

operating leverage that seems like it will likely result from lower enrollment growth. Just how you think about the tradeoff there in the decisions you're making?

Gary E. McCullough

The way we thought about it was we put ourselves in the shoes of the student. So, our goal is to get the best graduation rate, the best placement rate and get the people through the program and make sure when they leave the program they can have the best ability to meet the financial responsibilities that they signed up for coming into their program. That said, we looked at our programs and our loan programs to make sure that we're serving the students that have the best chance to not only graduate but meet the financial responsibility. Obviously, the lower the FICO score that you bring into the school and then when you do have a payment plan in place, the harder it is versus a high credit score student that you're going to make. We made various decisions between the variable costs, the outcomes, the placement rates and we skewed our decision making on both placement rate, graduation, retention, student success versus we did about we have cash on the balance sheet or we want to get more starts.

Analyst for Gary E. Bisbee – Lehman Brothers

Okay. Do you guys have a metric for graduation rates that you track? Or, is that something you'd be willing to disclose?

Gary E. McCullough

We track it. We typically do not disclose it.

Operator

Your next question will come from Andrew [Whitenberry] with Genesis. Please proceed.

Andrew [Whitenberry] – Genesis

You mentioned just the operating income hit as you teach out these schools and you talked about the accelerated depreciation impact of the operating income number. Can you help us think about how big that is as a percent of the total operating income loss for that piece of the business in 2008?

Michael J. Graham

I don't have those details available. Again, remember these schools are leased, they are not owned. So the component of depreciation you have is on equipment which is short life anyway, you know has some residual. The remaining depreciation on the leasehold improvements which are not as big if you owned the building so the relative magnitude versus some of the owned schools is a lot less.

Andrew [Whitenberry] – Genesis

Okay. Could you also help us think about , if we're just thinking about the business on an EBITDA basis, if we're looking at 2007, what do we need to add back in terms of charges, severance, write downs, etcetera to get to kind of a core number so we can think about what 2008 looks like?

Michael J. Graham

I think if you look at 2007 you can get to an EBITDA number obviously from the press release with depreciation being laid out. We did during the course of the year on each of the earnings calls describe certain things that we had happen, *i.e.* we had a \$13.5 million charge back in the middle of the year for different legal expenses laid out. We have on the income statement itself the impairment line which you can add back on the teach outs and things like that. It's up to you in terms of how you normalize things like the legal costs we talked about today or other onetime items. We'd be happy after the call to spend some time with you, go through the past scripts and give you a list of things we've outlined for people and then let you make your decisions on normalization.

Andrew [Whitenberry] – Genesis

Could you also talk about cap ex for 2008 and are there any cash tax refunds etcetera after all this is flowing through?

Michael J. Graham

To the first part of your question, we build a cap ex plan, it's consistent with the normal cap ex plan that we've had, somewhere around the 3% revenue level. Our cap ex is driven by certain start ups we have. We are opening up our LCB Boston school in the first quarter. We have two kitchen academies that open next year so we're still spending on our startups. We have a

normal technology spend. So I don't think it will be materially different than our normal percentage of revenue on a capital basis.

Andrew [Whitenberry] – Genesis

Any thoughts on the taxes?

Michael J. Graham

In terms of the tax rate?

Andrew [Whitenberry] – Genesis

I mean, given all the charges, etcetera, are there any cash tax refunds that you will get? Or, will your cash tax rate, obviously it will be lower in 2008. Are there any wrinkles there that we should think about on a cash basis?

Michael J. Graham

It will take a lot of work to do a cash tax basis because all these charges are typically deductible as paid on a lot of these different things. From a tax rate standpoint as you look at next year, we'll still have to model out our blend of foreign earnings which benefit us and our bottle of tax exempt interest on a number. But, a cash tax basis is a lot harder to calculate out right now.

Operator

Our next question will come from the line of Kevin Doherty with Banc of America Securities. Please proceed.

Kevin Doherty – Banc of America

I just had a question about bad debt expense, I wanted to see if you could maybe isolate the impact that the teach outs are going to have next year and I guess bad debt expenses had been trending down. Was that partially because the schools were in discontinued operations last year?

Michael J. Graham

To the latter question, no because the bad debt expense is on continuing operations so the discontinued operations had their own bad debt expense

within their business. Within a teach out you may have some higher bad debt expense as students decide necessarily not to complete their programs or leave behind some of their financial responsibilities. Within the number we gave you, we have modeled the bad debt expense out but we're not going to disclose that on the specific school basis or discontinued ops basis.

Kevin Doherty – Banc of America

Is it fair to assume that those students in the underperforming schools had a higher bad debt expense versus the company average?

Michael J. Graham

I don't know if it's fair to assume that. We did say that the Gibb schools did have a higher use of the recourse program. We talked about Culinary and Gibbs were two of the higher users of the recourse program. Nothing in our models indicated that the bad debt experience for the discontinued schools was materially different than what the traditional continuing schools were.

Kevin Doherty – Banc of America

A question for Gary, kind of given all the changes you discussed today, how do you think about the longer term margin potential of this business? Maybe particularly how you felt about the business when you took over last year?

Gary E. McCullough

I'll start by saying that I am probably more optimistic today about what we can do than I ever have been. I think what we're doing right now, what we're attempting to do is lacing it out as openly as we can given the situation we're in, deal head on with the issues that we're faced with so we can move through this and be a stronger company at the other side. We recognize that in the near term it's going to be challenging. I think when you come into a new role as I did, there's always something you don't expect both on the positive side and the negative side and I've seen plenty of both on that front. But, we've got a great team and I'm looking forward to moving forward from here. With that said, as I think about the margin potential of the business I really am not changing where I've been. I think we have to

make some near term changes in our business, particularly in culinary but when you look at what's happening in our business, we're going to move through and begin to build AIU back.

You've seen the good movement at [inaudible] in terms of the margin profile. We've indicated that long term we believe in the online business, we can get somewhere between 25 and 30%. Our healthcare business which was a couple of years ago, was losing money is now making money and improving on a daily, weekly and monthly basis. So, what I've said is I believe that we're going to get into the mid teens, the 20% margins. Overall, I still stand by that but we've got work to do to get there. So, we're making the hard organizational choices that we have to make and we're going to do the things that are right if necessary to deliver great student outcomes and I think that quality over time will benefit us so that is what we're about doing. I hope that answers your question.

Kevin Doherty – Banc of America

Just in terms of pricing, how important it is for you guys to eventually come back and get some sort of price increase over time to start achieving some of those longer term operating metrics that you talked about?

Gary E. McCullough

When we work through our plan, we did not assume that we were going to take significant pricing to get there. As we've begun to work in the company and as we've looked at the way we've operated we believe that we are not operating as effectively and efficiently as we can to go forward so we're working at taking some of that inefficiency, some of those unnecessary costs out of our system.

Now, I don't believe that we can cut our way to glory because ultimately you have to grow the business but the changes that we're making are challenging but, I think as we demonstrated last quarter we've made changes, we've reduced headcount in admissions and some other places yet we're still able to drive population and start growth. So, we're looking at finding the balance we need to find in our business to go forward. But, we have not assumed in the numbers I've talked to you about taking pricing. I think to take pricing you've got to make sure that you're hitting on a number of cylinders and people see the value that you deliver to them. We've got work to do on that front I think in all of our businesses. So, at that point in

time that we believe that we're either not priced competitive, that we're priced at a disadvantage versus our competition we will look at making adjustments in pricing. But, at the moment we're looking at driving both our revenue and operating margin increases in a different way.

Michael J. Graham

That said, back to the earlier comment we look at the pricing on a market-by-market basis and our long term plans assume pricing in line with market increases at we go along.

Operator

Our next question is a question from the line of Jennifer Childe with Credit Suisse. Please proceed.

Jennifer Childe – Credit Suisse

A couple of questions, was there anything unusual about the CTU online margins this quarter? And, is 29% sustainable?

Gary E. McCullough

Was there anything usual, not necessarily unusual, it was a bit higher than we had anticipated. The business, the CTU business did a fantastic job in the fourth quarter. They were able to get a great deal of operating leverage versus where they were last year from the additional population, the additional starts. They did reduce some headcount in admissions and they did pull back a bit on advertising towards the end of the year that may have given them a little bit of an upside there in the fourth quarter in terms of the business. We've said all along that we think the sustainable margins for the online businesses are someplace to the 25 to 30% range over time and to have a 29% in the fourth quarter, we were delighted to have that result.

Jennifer Childe – Credit Suisse

So probably that ticks down a little bit?

Gary E. McCullough

Like I said there were some short term savings in advertising and admission rep that the business benefited from that we don't intend to

sustain that over time. We want to make sure we spend everything we can behind the growing brand and make sure we have a full staff level.

Jennifer Childe – Credit Suisse

Then can we go back to the \$40 to \$60 million, do I understand correctly that that is the companywide impact including the teach out schools? So, if we're trying to calculate the impact on a continuing operations basis, not necessarily from the GAAP accounting standpoint but, you know what I'm saying continuing operations excluding the teach out, what would it be? What should the offsets be?

Michael J. Graham

If one were to build a model one would take the discontinued operations, move it up into continued operations, move the segments around as we gave some color around to move that around and then after that model the base business growth that you think is appropriate and then off of that take this total impact from the lending which does include, in the \$40 to \$60 million it does include the teach outs. Now, recognize in the teach outs that you only have serial volume because in teach outs you have no new starts. So, in that revenue loss of \$75 million disproportionate loss is for teach outs because you only have to cover serial volume and not new starts.

Jennifer Childe – Credit Suisse

Can you throw some numbers in?

Michael J. Graham

Not at this time.

Operator

That concludes our question and answer session for today. I would now like to turn the presentation back over to Gary McCullough for closing remarks.

Gary E. McCullough

Thank you all for participating on our call this morning. We recognize there's a lot to digest in the information that we shared with you but we worked as hard as we can and as quickly as we can to be able to provide

you color for where we stand at this point in time. As I said, our company has faced significant challenges over the last several years and in 2007 with the addition of some new key leadership with them working with the others who are already here, we really took the time to identify the challenges we thought we would face and defined our goals, our strategic choices and made sure that our organization begins to ready itself to deliver impactful long term change and strong operating results as we go forward. We're beginning 2008 by making the necessary changes we have to make in our organization and what we're working to do is set the baseline for a bright future to go forward. I recognize that there's a lot of what we have to do to drive cultural change, to drive better operating results and we're up to the challenge of making that happen. We appreciate your time and your attention and your interest in our company and we'll look forward to talking with you at our next opportunity. Thanks.

Operator

Thank you for your participation in today's conference. This concludes your presentation. You may now disconnect. Good day.

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